22 April 2022

Ferrous: Read-across from production results of iron ore majors

- **Iron ore price likely to remain elevated through the June quarter as supply issues persist**
- **Pace of softening of coking coal price dependent on restoration of export volumes; BHP guidance suggests initial signs of improvement**
- **Expect steel price to ease to mid-cycle level given sharp cuts in WSA's CY22 demand growth forecast and likely unwinding of supply disruptions**

Kirtan Mehta, CFA
researchreport@bobcaps.in

The four global iron ore majors – Vale (Vale3 BZ), Rio Tinto (RIO LN), BHP (BHP LN) and Anglo American (AAL LN); all Not Rated – have reported production results for the Mar'22 quarter. We summarise the read-across for Indian steel markets.

Iron ore price to remain elevated through the Jun quarter: Iron ore supply across all three major exporters – Australia, Brazil and South Africa – underperformed expectations during the March quarter. Collective shipments of the four majors, which account for close to 60% of global iron ore trade, declined 20% QoQ and 6% YoY. Delays in ramp-up, replacement and growth projects have affected production, besides the impact of a severe wet season due to La Niña. Guidance from the majors suggest that supply issues could persist through the June quarter and keep iron ore prices elevated. The Russia-Ukraine situation will also weigh on prices.

Coking coal price to ease with improvement in Australian supply: Australian supply disruptions have been a key driver of the sharp rise in coking coal prices during the March quarter. While BHP guidance suggests initial signs of supply improvement, the pace at which prices will cool down depends upon a ramp-up of exports.

Steel demand expectations revised down: World Steel Association (WSA) has lowered its CY22 demand growth forecasts to 0.4% (from 2.2%), factoring in global spillovers of the Ukraine war and low growth in China. However, WSA does expect China demand to stabilise this year given a government push for infrastructure investment and efforts to support the real estate sector.

Read-across for Indian ferrous industry: While steel prices have been supported by concerns related to the Russia-Ukraine war, we forecast a softening to mid-cycle levels of US$ 650/t over FY24 as supply disruptions unwind in the coking coal and iron ore markets. A muted demand growth outlook for CY22 would also gradually lead to cycle-average margins. We expect margins to hold at these levels, supported by the differential in iron ore costs.

WSA cuts steel demand outlook

World Steel Association has slashed its steel demand growth forecast for CY22 to 0.4% (Apr'22) from 2.2% (Oct'21). The weaker forecast reflects global spillovers from the war in Ukraine along with low growth in China. For CY23, WSA expects 2.2% growth assuming an end to the Ukraine confrontation at some point in CY22 but continued sanctions on Russia.

- **China:** WSA expects China's steel demand to remain flat in CY22 amid the government-led boost to infrastructure investment and efforts to stabilise the real estate market.
- **Advanced economies:** The steel body has a weakened outlook for advanced economies amid inflationary pressure, cutting its forecast for European steel demand growth to flat YoY (from 5.8%) and USMCA growth to 3.0% (from 5.3%).
- **Developing economies ex-China:** WSA forecasts low growth of 0.5% in CY22 factoring in challenges from the worsening external environment, the Russia-Ukraine war and US monetary tightening.

Fig 1 – World steel demand growth forecasts

Date of forecast	Steel demand forecasts (mt)			Demand growth forecast (%)				
	Apr'22			Actual	Apr'22		Oct'21	
Year	2021	2022F	2023F	2021	2022F	2023F	2021E	2022E
Europe	204	204	212	15.8	0.0	4.0	13.5	5.8
USMCA	137	141	145	20.5	3.0	2.6	13.7	5.3
Asia ex-China	346	361	375	11.6	4.3	3.9	11.3	4.3
Others	195	182	188	9.2	(6.4)	3.0	8.6	3.8
World ex-China	882	888	920	13.3	0.7	3.5	11.5	4.7
China	952	952	962	(5.4)	0.0	1.0	(1.0)	0.0
World	1,834	1,840	1,881	2.8	0.4	2.2	4.5	2.2

Source: World Steel Association, BOBCAPS Research

Rio Tinto acknowledged that market demand expectations have been revised downwards amidst sustained high inflation, the outbreak of the Russia-Ukraine war, and a resurgence of Covid-19 lockdowns in China. The company sees further downside risks from a prolonged war and other geopolitical tensions, extended labour and supply shortages, and monetary policy adjustments to curb inflation. While infrastructure spending is lending a fillip to China's economy, Covid-19 lockdowns pose risks to near-term construction activity.

Iron ore supply weak due to project delays, seasonal decline

During the March quarter, Australian supply underperformed with Rio Tinto missing the consensus production forecast (71.5mt vs. Bloomberg consensus of 73.5mt) and BHP's Western Australia operations staying barely in line (67.1mt vs. 67.2mt). Brazilian supply also disappointed with a miss by Vale (63.9mt vs. 67.8mt) and, in South Africa, Anglo American lowered its CY22 guidance for Kumba operations to 38-40mt (39-41mt previously) after seeing a 21% QoQ decrease in the March quarter.

Collective shipments of the four majors, which account for close to 60% of global iron ore trade, were down 20% QoQ and 6% YoY. During the quarter, iron ore availability was impacted by project delays as well as the wet season.

- Anglo American's iron ore sales declined 18% QoQ due to the impact of high rainfall and plant issues at both Kumba in South Africa and Minas-Rio in Brazil.
- Rio Tinto attributed its underperformance to delayed ramp-up of Pilbara growth and replacement projects (Gudai-Darri, Rob Valley).
- BHP stated that its weaker performance stemmed from temporary labour constraints due to Covid-19, train driver shortages and planned maintenance.
- Vale highlighted licensing delays at Serra Norte, underperformance at S11D and Sossego, and major maintenance work besides the impact of heavy rains at Minas Gerais in Jan'22.

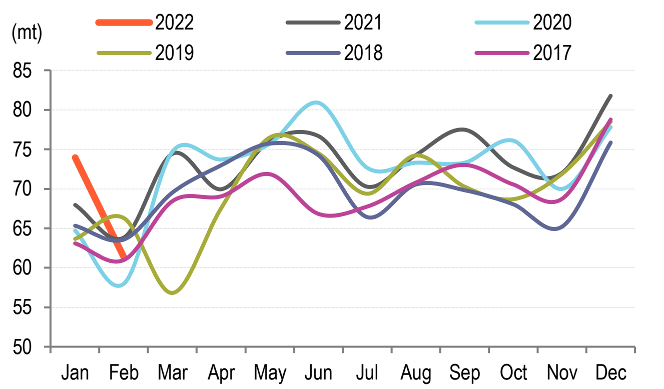
Fig 2 – Iron ore sales of global majors

(mt)	Q1CY21	Q2CY21	Q3CY21	Q4CY21	Q1CY22	QoQ (%)	YoY (%)
AAL LN	15.7	15.0	15.8	16.8	13.8	(17.6)	(12.0)
BHP LN	66.0	73.7	70.8	73.2	67.1	(8.3)	1.6
RIO LN	77.8	76.3	83.4	84.1	71.5	(15.0)	(8.1)
VALE3 BZ	59.3	67.2	67.8	83.1	53.6	(35.5)	(9.6)
Total of 4 majors	**218.8**	**232.2**	**237.8**	**257.2**	**206.0**	**(19.9)**	**(5.9)**
FMG AU	42.3	49.3	45.6	47.5	na	-	-
Total of 5 majors	**261.1**	**281.5**	**283.4**	**304.7**	**na**	**-**	-

Source: Company, BOBCAPS Research

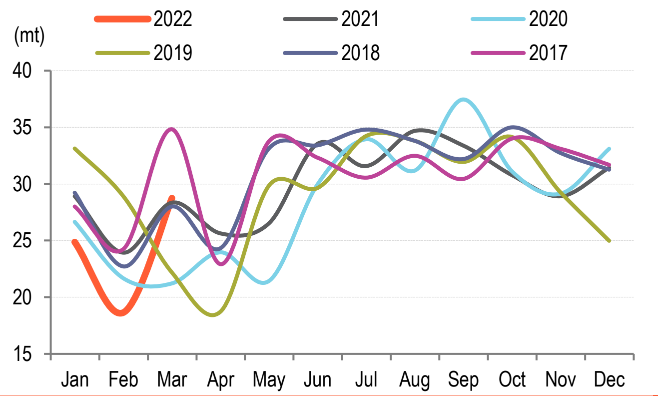
Iron ore supply weakness is also visible in the country-level export data reported by Australia and Brazil.

Fig 3 – Australian iron ore exports (monthly) weakened in February



Source: Bloomberg, BOBCAPS Research

Fig 4 – Brazilian iron ore exports (monthly) recovered in March after underperforming in February

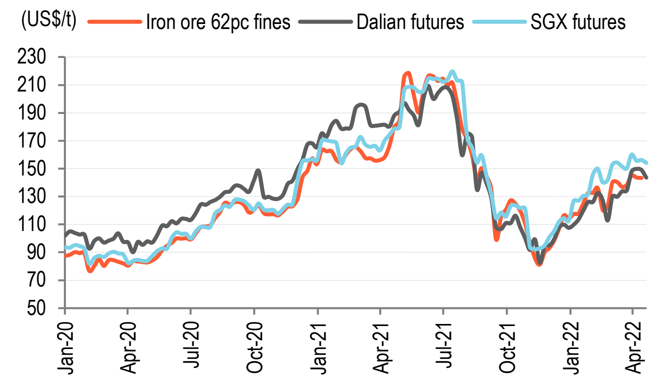


Source: Bloomberg, BOBCAPS Research

Iron ore supply issues to continue in June quarter

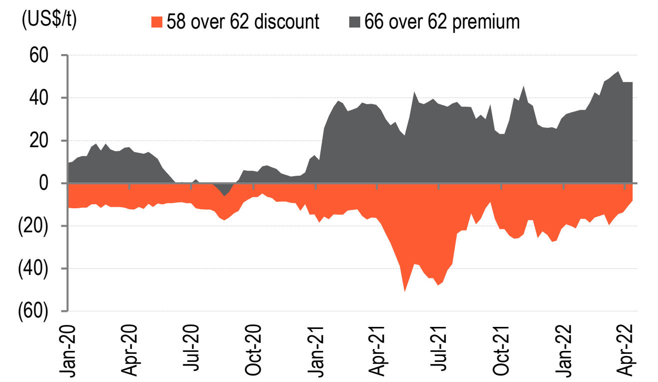
Iron ore prices have increased since Jan'22 despite muted demand. The increase was initially supported by a seasonal decline in iron ore availability and, more recently, by concerns on the impact of the Russia-Ukraine war. Given a seasonal uptick in steel demand in Q2 (despite below-expected China recovery) and continuing iron ore supply issues, prices could remain high through the April-June quarter.

Fig 5 – Iron ore price



Source: Bloomberg, BOBCAPS Research

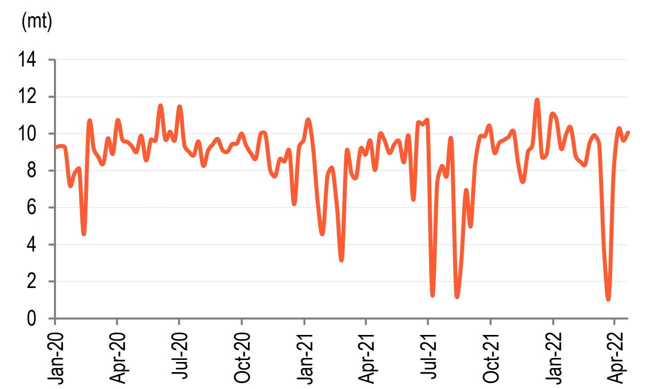
Fig 6 – Iron ore grade premium



Source: Bloomberg, BOBCAPS Research

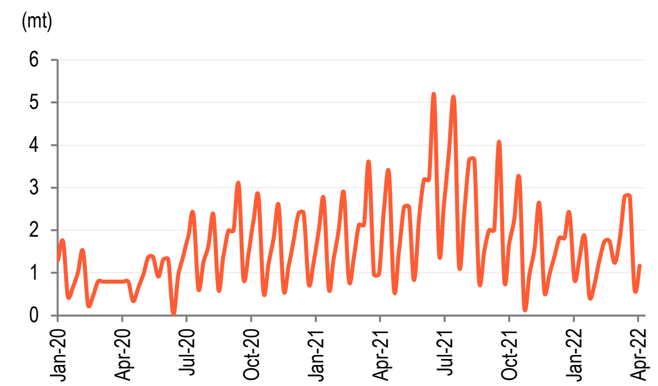
Weekly export data from Australia and Brazil so far shows only a modest recovery.

Fig 7 – Australia Port Hedland iron ore export (weekly) shows only a modest recovery in April



Source: Bloomberg, BOBCAPS Research

Fig 8 – Brazil iron ore exports (weekly) remain muted



Source: Bloomberg, BOBCAPS Research

The guidance from majors suggests that supply issues will weigh on production/exports over Q2CY22.

- Anglo American has cut its CY22 annual iron ore production guidance to 60-64mt from 63-67mt.
- BHP's annual guidance indicates only a marginal QoQ improvement in production (0-10mt) over Apr-Jun'22. BHP expects production to be impacted by continued Covid-19 related absenteeism (as Western Australia approaches anticipated peak case numbers) and planned car dumper maintenance.

- Rio Tinto guides for improvement in iron ore shipments only during H2CY22 after ramp-up at its Gudai-Darri project in Western Australia.
- Brazilian iron ore supply typically recovers from seasonal logistical disruptions typically after May.

Coking coal rises on Australia supply disruptions

Australia accounts for nearly half of global seaborne coking coal trade. Supply disruptions to Australian output have been instrumental in fuelling the recent sharp increases in coking coal prices. Supply has been impacted by the ongoing La Niña event, floods in Queensland and unpredictable worker absences with the rise in Covid-19 cases. A recovery in Australian production and exports holds the key to an easing of coking coal prices.

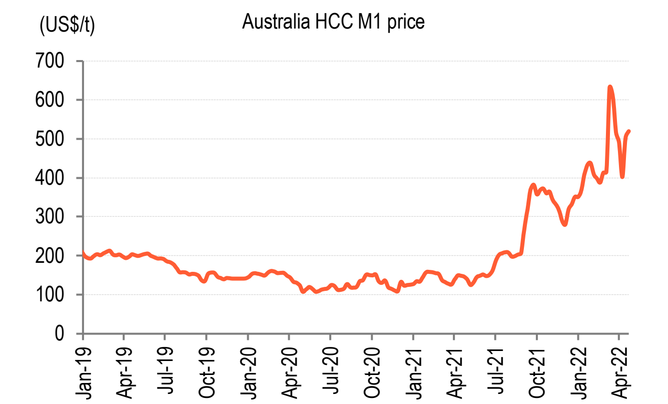
BHP-managed coal mines in Queensland account for ~40% of Australian coking coal exports and have posted a 23% QoQ recovery in sales growth during Q1CY22. Annual guidance for FY22 (ending June) implies a potential 0-20% increase in the June quarter. However, coking coal sales reported by Anglo American and Vale do show seasonal weakness. Anglo American attributed the underperformance to delays in ramp-up of Moranbah longwall mining operations.

Fig 9 – Coking coal sales show a mixed trend

(mt)	Q1CY21	Q2CY21	Q3CY21	Q4CY21	Q1CY22	QoQ (%)	YoY (%)
BHP (@100% of mine volumes)	17.8	21.1	15.6	14.4	17.8	23.5	0.5
AAL (@ attributable share)	3.1	2.9	4.0	4.2	2.4	(41.9)	(21.9)
VALE3	0.6	1.0	1.1	1.2	0.9	(25.8)	59.0

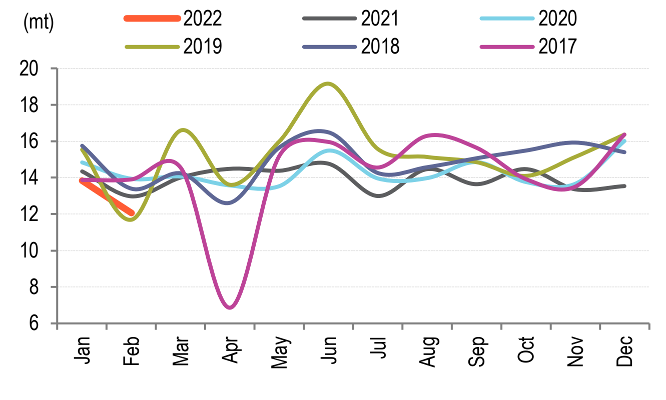
Source: Company, BOBCAPS Research

Fig 10 – Australia coking coal price proxy



Source: Bloomberg, BOBCAPS Research

Fig 11 – Australia coking coal price proxy



Source: Bloomberg, BOBCAPS Research

Thermal coal production impacted in Australia and S. Africa

- BHP's thermal coal production was down 27% QoQ in the March quarter due to wet weather coupled with the impact of Covid-related absenteeism on stripping and mining activities.
- Vale highlighted disruptions to coal production in South Africa in January and February as the impact of cyclone Ana restricted rail transportation and inventory management. However, weather conditions have improved in March and operations are being normalised.
- Improvement in supply from Australia and Indonesia is essential for a cooldown of global thermal coal prices.

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Rating distribution

As of 31 March 2022, out of 116 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 65 have BUY ratings, 31 have HOLD ratings, 5 are rated ADD*, 1 is rated REDUCE* and 14 are rated SELL. One company rated ADD has been an investment banking client in the last 12 months. (*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities —that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.